

**IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION**

IN RE: §
§
DIVERSIFIED SOLUTIONS, INC., § **CASE NO. 14-10069-TMD**
§
DEBTOR. § **CHAPTER 11**

**DIVERSIFIED SOLUTIONS, INC.’S REPLY IN SUPPORT OF ITS
EXPEDITED MOTION TO ENFORCE THE AUTOMATIC STAY**

[Relating to Docket No. 4]

Diversified Solutions, Inc. (the “Debtor”) files its *Reply in Support of its Expedited Motion to Enforce the Automatic Stay* (“*Reply*”). In support of its *Reply*, the Debtor states the following:

I. PRELIMINARY STATEMENT

1. In 2004, the Debtor executed an indemnity agreement in which the Debtor agreed to indemnify, defend, and hold harmless Brian Sol and Michael Lundy, its corporate officers, for any and all claims.¹ This indemnity agreement is sufficient to extend the automatic stay to the fraud claim against Brian Sol and Michael Lundy in the pending federal court litigation because “there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party defendant will in effect be a judgment or finding against the debtor.” *Reliant Energy Servs. v. Enron Canada Corp.*, 349 F.3d 816, 825 (5th Cir. 2003), quoting *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 999 (4th 1986). Because of the indemnity agreement, a judgment against either Brian Sol or Michael Lundy will, in effect, be a judgment against the Debtor. *Compare with Arnold v. Garlock*, 278 F.3d 426, 436 (5th Cir. 2001) (declining to extend the automatic stay to non-debtors because, “There is no claim of a formal tie or contractual indemnification to create such an identity of

¹ The indemnity agreement is attached as *Exhibit A*.

interests.”). Thus, this Court should extend the automatic stay to Brian Sol and Michael Lundy in the pending federal court litigation.

II. ARGUMENT

2. “Once a party files in bankruptcy, under Chapter 11, for example, 11 U.S.C. § 362, et seq., stays further actions against the debtor. Virtually any act attempting to enforce a judgment against or obtain property from the estate of the debtor is stayed once the title 11 proceedings are commenced.” *Id.* at 435-36. The automatic stay generally does not apply to non-debtors. *Id.* at 436.

3. However, courts have extended the automatic stay to non-debtors “when there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party defendant will in effect be a judgment or finding against the debtor.” *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 999 (4th Cir. 1986). *See also Reliant Energy*, 349 F.3d at 825 (stating same). The debtor in *A.H. Robins* was the manufacturer of the Dalkon Shield, an intrauterine device. *A.H. Robins*, 788 F.2d at 996. Several lawsuits were filed against the debtor alleging that the Dalkon Shield was defective. *Id.* The debtor’s liability insurer or officers were defendants in some of these lawsuits. *Id.* at 996-97.

4. The Fourth Circuit extended the automatic stay to litigation against the Debtor’s officers because it recognized an extension is appropriate in certain situations. “An illustration of such a situation would be a suit against a third-party who is entitled to absolute indemnity by the debtor on account of any judgment that might result against them in the case.” *Id.* at 999. Using this reasoning, the Fourth Circuit in *A.H. Robins* extended the automatic stay to the Debtor’s officers because the officers had indemnification rights against the Debtor. *Id.* at 1008.

4. The Fifth Circuit has used the same standard set out in *A.H. Robins* in determining whether the automatic stay extends to non-debtors. *See Arnold*, 278 F.3d at 436; *Reliant Energy*, 349 F.3d at 825. In *Arnold*, the Fifth Circuit declined to extend the automatic stay to a non-debtor because, unlike the officers in *A.H. Robins*, the non-debtors did not have a formal tie to or indemnification rights against the debtors. *Arnold*, 278 F.3d at 436. *See also Reliant Energy*, 349 F.3d at 826 (remanding back to district court to determine whether master netting agreement involving bankrupt Enron entities was a joint obligation).

5. In this case, Brian Sol's and Michael Lundy's indemnification rights against the Debtor are intertwined with the Debtor such that the Debtor remains the real party in interest in the federal court litigation against Brian Sol and Michael Lundy. "An indemnification claim against the debtor—even if it is ultimately unsuccessful—may fall within § 362(a)(3) because it has an 'immediate adverse economic consequence for the debtor's estate.'" *In Re Jefferson County, Alabama*, 491 B.R. 277, 296 (Bankr. N.D. Al. 2013). This is because, "a claim against the [indemnitees] will, when entered, constitute a claim (and hence, an 'immediate adverse economic consequence') against the estate." *Queenie, Ltd. v. Nygard Int'l*, 321 F.3d 282, 287 (2d. Cir. 2003).

6. Additionally, to permit the fraud claim to proceed against these two individuals but not the Debtor will create a potential preclusive effect against the Debtor. "[C]ourts have stayed proceedings against non-debtor defendants when the proceedings would have a potential preclusive effect that would force the debtors to participate in the proceedings as if they were a party." *Jefferson County*, 491 B.R. at 293. That is exactly what the Debtor is facing in the federal court litigation. The fraud claim asserted against Brian Sol and Michael Lundy is exactly the same fraud claim asserted against the Debtor. Additionally, the fraud claim against Brian Sol

and Michael Lundy incorporates allegations and theories of liability advanced in claims that are asserted against only the Debtor. Should the federal court litigation proceed against Brian Sol and Michael Lundy, the Debtor would either: (i) be forced to participate in the federal court litigation so that it can avoid potential issue preclusion or (ii) not participate in the federal court litigation and run the risk of issue preclusion with respect to the claims asserted against it. This is an untenable result, and further illustrates why this Court should extend the automatic stay to Brian Sol and Michael Lundy.

WHEREFORE, the Debtor requests that this Court: (i) enter an order extending the automatic stay to Brian Sol and Michael Lundy and (ii) grant such further relief to which the Debtor is justly entitled.

Date: January 20, 2014

HUSCH BLACKWELL LLP
111 Congress Avenue, Suite 1400
Austin, Texas 78701
(512) 472-5456
(512) 226-7318 (fax)
lynn.butler@huschblackwell.com
sam.chang@huschblackwell.com

By: /s/ Lynn Hamilton Butler

Lynn Hamilton Butler
State Bar No. 03527350
Sam Chang
State Bar No. 24078333

PROPOSED ATTORNEYS FOR
DIVERSIFIED SOLUTIONS, INC.

CERTIFICATE OF SERVICE

I hereby certify that on January 20, 2014, a true and correct copy of the foregoing pleading was served, via the Court's CM/ECF notification system to the parties registered to receive notice on such system, and via first class mail, the next day, to the parties on the attached mailing matrix.

/s/ Lynn Hamilton Butler
Lynn Hamilton Butler

Indemnification Agreement between Diversified Solutions, Inc. and its Corporate Officers

Diversified Solutions, Inc. shall fully indemnify, defend, and hold harmless its shareholders, directors, officers, (collectively the "Indemnified Parties") harmless from and against, and agree promptly to defend the Indemnified Parties from and reimburse the Indemnified Parties for, any and all losses, damages, costs, suits (civil or criminal), injuries (whether to person or property), deaths, expenses, liabilities, obligations and claims of any kind whatsoever (including, without limitation, reasonable attorneys' fees and other costs and expenses incurred in connection herewith or in the investigation of any claims made hereunder or enforcement of rights hereunder) (collectively, "Claims") incurred by any of the Indemnified Parties.

If any provision herein is held to be illegal or unenforceable the other provisions shall nevertheless remain in full force and effect.

Effective Date: 9/30/04

Authorized Signature:



Brian J. Sol/ Vice President/Secretary/ Chief Financial Officer

Date: 10/1/04

Authorized Signature: _____

Michael J. Lundy/ President & Chief Executive Officer

Date: _____

Label Matrix for local noticing

Diversified Solutions, Inc.

U.S. BANKRUPTCY COURT

0542-1

Of 3

903 SAN JACINTO, SUITE 322

Case 14-10069-tmd

8101 Avella Drive

AUSTIN, TX 78701-2450

Western District of Texas

Austin

Mon Jan 20 19:08:14 CST 2014

Adam S. Mocciole

Alison Marie Perry

Amber Giles

Pullman & Comley

Pullman & Comley

5102 Doss Road

850 Main Street

840 Main Street

Austin, TX 78734-1209

Bridgeport, CT 06604-4988

Bridgeport, CT 06604

American Express

Anthem Blue Cross

Audimation Services, Inc.

Attn: Bankruptcy Division

P.O. Box 9051

1250 Wood Branch Park Dr., Suite 480

P.O. Box 360002

Oxnard, CA 93031-9051

Houston, TX 77079-1212

Fort Lauderdale, FL 33336-0002

Brian J. Sol

CH Services, Inc.

Christopher P. McCormack

P.O. Box 2472

11011 Domain Drive

Pullman & Comley

Stateline, NV 89449-2472

Austin, TX 78758-7764

840 Main Street

Bridgeport, CT 06604

Cody Hobza

Dan Hernandez

(p)INTERNAL REVENUE SERVICE

13008 Hymeadow Circle

2635 W. 45th

CENTRALIZED INSOLVENCY OPERATIONS

Austin, TX 78729-1758

Austin, TX 78731-5941

PO BOX 7346

PHILADELPHIA PA 19101-7346

Diamond Aviation Services

Earthnet, Inc.

Elizabeth Viveros

3205 Paseo Vista

4735 Walnut St., Suite F

1175 Prussian Way

San Martin, CA 95046-9700

Boulder, CO 80301-2553

Oceanside, CA 92057-1840

Employment Development Department

FedEx

Franchise Tax Board

State of California

Attn: Bankruptcy Div.

Bankruptcy Section, MS A-340

Bankruptcy Unit - MIC 92E

P.O. Box 7221

P.O. Box 2952

P.O. Box 826880

Pasadena, CA 91109-7321

Sacramento, CA 95812-2952

Sacramento, CA 94280-0001

Garnet Analytics, Inc.

Halloran & Sage LLP

Internal Revenue Service

324 Elm Street, Suite 103B

Attn: Joseph J. Arcata, III, Esq.

P.O. Box 7346

Monroe, CT 06468-2283

One Goodwin Square

Philadelphia, PA 19101-7346

225 Asylum St.

Hartford, CT 06103-1516

Kondler & Associates

Larry Conklin

Lubich & Lubich

6460 Medical Center St., Suite 230

1175 Prussian Way

16375 Monterey Road, Suite N

Las Vegas, NV 89148-2421

Oceanside, CA 92057-1840

Morgan Hill, CA 95037-5442

Lynn H. Butler

Manaya Management, Inc.

Mark Astleford

Husch Blackwell LLP

P.O. Box 2472

15450 FM 1325 - Apt. # 1536

111 Congress Avenue, Suite 1400

Stateline, NV 89449-2472

Austin, TX 78728-2838

Austin, TX 78701-4093

Patricia Menz
2207 Pasadena Dr., #9
Austin, TX 78757-2214

Premiere Global Services
P.O. Box 404351
Atlanta, GA 30384-4351

Secretary of State
State of California
1500 11th Street
Sacramento, CA 95814-5701

Secretary of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220-0001

Sourcive, Inc.
4255 Garlan Lane
Reno, NV 89509-5444

(p)CALIFORNIA STATE BOARD OF EQUALIZATION
ACCOUNT REFERENCE GROUP MIC 29
P O BOX 942879
SACRAMENTO CA 94279-0029

Texas Attorney General
Bankruptcy & Collections Division
P.O. Box 12548
Austin, TX 78711-2548

(p)TEXAS COMPTROLLER OF PUBLIC ACCOUNTS
REVENUE ACCOUNTING DIV - BANKRUPTCY SECTION
PO BOX 13528
AUSTIN TX 78711-3528

Texas Workforce Commission
Tax-Collections
101 E. 15th Street
Austin, TX 78778-0001

Tristan Scott Cowperthwait
Pullman & Comley
840 Main Street
Bridgeport, CT 06604

U.S. Attorney General
Department of Justice
950 Pennsylvania Avenue NW
Washington, DC 20530-0009

(p)US BANK
PO BOX 5229
CINCINNATI OH 45201-5229

U.S. Department of the Treasury
Attn: Bankruptcy Dept.
Ogden, UT 84201-0001

Unified Services
2635 W. 45th
Austin, TX 78731-5941

United States Trustee - AU12
United States Trustee
903 San Jacinto Blvd, Suite 230
Austin, TX 78701-2450

Verizon
Attn: Bankruptcy Div
P.O. Box 920041
Dallas, TX 75392-0041

Verizon Wireless
Attn: Bankruptcy Div.
P.o. Box 660108
Dallas, TX 75266-0108

Wells Fargo Business Card
P.O. Box 54349
Los Angeles, CA 90054-0349

Williamson County Tax Assessor
904 South Main
Georgetown, TX 78626-5829

The preferred mailing address (p) above has been substituted for the following entity/entities as so specified by said entity/entities in a Notice of Address filed pursuant to 11 U.S.C. 342(f) and Fed.R.Bank.P. 2002 (g)(4).

Department of Treasury
Attn: Bankruptcy Div.
P.O. Box 105083
Atlanta, GA 30348

(d)Internal Revenue Service
Attn: Bankruptcy Division
P.O. Box 105078
Atlanta, GA 30348

(d)Internal Revenue Service
Attn: Bankruptcy Division
P.O. Box 105083
Atlanta, GA 30348

State Board of Equalization

Texas Comptroller

U.S. Bank

State of California

c/o Susan Combs

P.O. Box 790408

Account & Analysis & Control Section

P.O. Box 13528

Saint Louis, MO 63179

P.O. Box 942879

Austin, TX 78711-3528

Sacramento, CA 94279

The following recipients may be/have been bypassed for notice due to an undeliverable (u) or duplicate (d) address.

(d)Brian J. Sol.

P.O. Box 2472

Stateline, NV 89449-2472

(d)Lynn H. Butler

Husch Blackwell LLP

111 Congress Avenue, Suite 1400

Austin, TX 78701-4093

End of Label Matrix

Mailable recipients 51

Bypassed recipients 2

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